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In the Supreme Court of the United States

OCTOBER TERM, 1940

No. 101

HENRY F. DU PONT, PETITIONER

v.

GUY T. HELVERING, COMMISSIONER OF INTERNAL
REVENUE

*ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED
STATES CIRCUIT COURT OF APPEALS FOR THE THIRD
CIRCUIT*

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The opinion of the United States Board of Tax Appeals (R. 209) is reported in 38 B. T. A. 1317. The opinion of the Circuit Court of Appeals (R. 259) is reported in 110 F. (2d) 641.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered on February 28, 1940 (R. 266). The petition for a writ of certiorari was filed on May 25, 1940. The jurisdiction of this Court is invoked

under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether the sale of certain stock under the circumstances of this case was a short sale within the meaning of Section 23 (s) of the Revenue Act of 1932.

STATUTE INVOLVED

Revenue Act of 1932, c. 209, 47 Stat. 169:

SEC. 23. DEDUCTIONS FROM GROSS INCOME.

In computing net income there shall be allowed as deductions:

* * * *

(r) Limitation on Stock Losses.—

* * * *

(s) *Same—Short Sales.*—For the purposes of this title, gains or losses (A) from short sales of stocks and bonds, or (B) attributable to privileges or options to buy or sell such stocks and bonds, or (C) from sales or exchanges of such privileges or options, shall be considered as gains or losses from sales or exchanges of stocks or bonds which are not capital assets.

* * * *

STATEMENT

The facts, which were stipulated by the parties and adopted by the Board as its findings of fact (R. 210-221), may be summarized as follows:

The taxpayer is a resident of Winterthur, Delaware. During 1932 he was not engaged in the

trade or business of buying and selling securities, nor was he connected with any stock exchange or brokerage firm. He was, however, a holder of substantial blocks of stock of the duPont Company, General Motors Corporation, and other corporations. He purchased and sold large quantities of stock during 1932. (R. 213.)

Raymond W. Ellis was employed as a customers' man by Laird, Bissell & Meeds, a firm of stockbrokers and members of the New York Stock Exchange, with offices located in Wilmington and New York City. Ellis had a clientele of his own and maintained an office separate from that of Laird, Bissell & Meeds but located in the same building. (R. 213-214.)

The taxpayer was accustomed during the year 1932 and for several years prior thereto to rely upon the advice of Ellis as to all matters concerning the purchase and sale of securities. The taxpayer was not familiar with the provisions of the federal income-tax laws, but Ellis was considered an expert in that field. It was taxpayer's custom in buying and selling securities to advise Ellis of the transactions he wished to make. Taxpayer was not accustomed to instruct Ellis as to the manner in which purchases or sales should be made, nor as to which one of his accounts purchases or sales should be made for, but relied upon Ellis to handle such transactions in whatever way would be most advantageous to taxpayer from the standpoint of income or other taxes. In return for Ellis' serv-

ices in this connection taxpayer during 1932 placed all of his orders for the purchase and sale of securities through Ellis and also paid him a yearly fee of \$1,000. The taxpayer's federal income-tax return for 1932 was prepared for the taxpayer by Ellis. (R. 214.)

The taxpayer maintained five accounts during the calendar year 1932 with the Wilmington office of Laird, Bissell & Meeds. These accounts were designated respectively "H. F. duPont," "H. F. duPont Special," "H. F. duPont Short," "H. F. duPont Short No. 2," and "H. F. duPont Special Short." (R. 214.)

Orders for sales of stocks in 1932 were ordinarily placed with the Wilmington office of Laird, Bissell & Meeds by Ellis pursuant to oral instructions from the taxpayer and then sent by telephone to Laird, Bissell & Meeds' New York office. The sales were then made by the brokers on the floor of the New York Stock Exchange in the ordinary course of business. Deliveries to purchasers were made on the following full business day out of shares belonging to Laird, Bissell & Meeds or their customers, or from shares borrowed by them from other brokers. The proceeds of the sales were credited to taxpayer's respective accounts as directed by Ellis. (R. 214-215.)

As of April 1, 1932, the taxpayer was indebted to the Bankers Trust Company of New York in the amount of \$4,000,000. The indebtedness was se-

cured by collateral which included 90,000 shares of the common stock of the duPont Company. The Bankers Trust Company requested the taxpayer to deposit additional collateral or else to reduce the indebtedness. The Bankers Trust Company was willing to release 62,500 shares of the duPont stock upon the payment to it of \$2,000,000 in reduction of the taxpayer's indebtedness. He contracted to sell to the Christiana Securities Company 62,500 shares of duPont common stock at that price. The Christiana Securities Company made an arrangement with J. P. Morgan & Company of New York to lend it \$2,000,000 upon the security of 62,500 shares of duPont stock. (R. 215.)

On or about April 20, 1932, the taxpayer advised Ellis of the arrangements which he had made with the Bankers Trust Company and the Christiana Securities Company and requested Ellis "to handle the matter" for taxpayer through Laird, Bissell & Meeds. On the same day Ellis wrote and transmitted to the New York office of Laird, Bissell & Meeds a memorandum of instructions reading as follows (R. 215-216):

APRIL 20, 1932.

MEMORANDUM TO: Mr. John Ross

FROM: R. W. Ellis

You are to pay to the Bankers Trust Company two million dollars (\$2,000,000), receiving sixty-two thousand five hundred (62,500) shares duPont Common in the name of H. F. duPont. You are to place in

the name of Laird, Bissell & Meeds the sixty-two thousand five hundred (62,500) shares duPont Common.

We will make delivery in Wilmington of sixty-two thousand five hundred (62,500) shares duPont Common, preferably in stock other than certificates which you receive from the Bankers Trust Company. In fact, to eliminate any possible chance of being taxed on the sale, we must see to it that none of the Bankers Trust certificates are used in making this delivery.

[Signed] R. W. ELLIS

On April 21, 1932, Ellis, using the form of buy and sell orders used by Laird, Bissell & Meeds for investment purchases and sales for its own account (as distinguished from the form of buy and sell orders for the accounts of customers), made out a buy order showing that Laird, Bissell & Meeds purchased 62,500 shares of duPont Company common stock for \$2,000,000 from "H. F. duPont Short No. 2" account, and a sell order showing that Laird, Bissell & Meeds sold for \$2,000,000 to the Christiana Securities Company 62,500 shares of duPont common stock. (R. 216.)

Upon receipt of the memorandum of instructions from Ellis, the New York office of Laird, Bissell & Meeds received from the Bankers Trust Company through the Stock Clearing Corporation 62,500 shares of common stock of the duPont Company. The certificates were all registered in the name of the taxpayer and were accompanied by blank pow-

ers of attorney for transfer properly endorsed by the taxpayer. At the same time the Bankers Trust Company billed Laird, Bissell & Meeds through the Stock Clearing Corporation for \$2,000,000 against this delivery of 62,500 shares of the common stock of the duPont Company. Payment was made by Laird, Bissell & Meeds to the Bankers Trust Company through the Stock Clearing Corporation in their daily settlement check. The certificates which Laird, Bissell & Meeds received from the Bankers Trust Company were delivered to the transfer agent of the duPont Company on April 21, 1932, and new stock certificates were received by Laird, Bissell & Meeds from the transfer agent the same day, all in the name of Laird, Bissell & Meeds. (R. 216-217.)

On the same day, April 21, 1932, Laird, Bissell & Meeds delivered to J. P. Morgan & Company stock certificates for 62,500 shares of the common stock of the duPont Company and received from J. P. Morgan & Company a check drawn to the order of Laird, Bissell & Meeds in the amount of \$2,000,000. Of the stock certificates delivered to J. P. Morgan & Company, certificates representing 40,500 shares of the common stock of the duPont Company were part of the certificates previously issued on the same day in the name of Laird, Bissell & Meeds by the transfer agent of the duPont Company. The remaining certificates, representing 22,000 shares of the common stock of the

duPont Company, were either in the name of Laird, Bissell & Meeds or in street names and were not a part of the series which Laird, Bissell & Meeds had on the same day received from the transfer agent. (R. 217.)

The accounting records of Laird, Bissell & Meeds show 62,500 shares of duPont Company common stock received from the New York office for the "H. F. duPont Special" account (a long account) at a charge of \$2,000,000. They also show 62,500 shares of the duPont stock delivered to the New York office for the Christiana Securities Company account at a charge of \$2,000,000. (R. 217.)

On April 21, 1932, Laird, Bissell & Meeds delivered confirmation notices to the taxpayer notifying him that his "H. F. duPont Short No. 2" account was credited in the sum of \$1,999,250 as the proceeds of the sale of 62,500 shares of duPont Company common stock, and that his "H. F. duPont Special" account was charged in the sum of \$2,000,000 against receipt of 62,500 shares of the same stock. Upon receipt of these confirmation notices entries were made on taxpayer's books in accordance therewith as shown in taxpayer's ledger accounts entitled "Laird Bissell and Meeds—H. F. duPont Short Account #2" and "Laird Bissell and Meeds—H. F. duPont Special Account." (R. 217-218.)

The investment ledger of Laird, Bissell & Meeds reflects purchases and sales by Laird, Bissell &

Meeds for its own account as principal. On April 21, 1932, an entry was made in the Laird, Bissell & Meeds investment ledger account entitled "E. I. duPont de Nemours & Co. Common Stock," showing a purchase on that date from "H. F. duPont Short No. 2" account of 62,500 shares for \$2,000,000 and a sale on that date to the Christiana Securities Company of 62,500 shares at a price of \$2,000,000. The sale by taxpayer of 62,500 shares of duPont Company common stock is recorded in the ledger account entitled "H. F. duPont Short No. 2" under date of April 22, 1932. The receipt of 62,500 shares is recorded in the account entitled "H. F. duPont Special" under date of April 21, 1932. (R. 218.)

About four months later, on August 19, 1932, taxpayer through Ellis instructed Laird, Bissell & Meeds to transfer the entire balance of 62,500 shares of common stock of the duPont Company in his "H. F. duPont Special" account to his "H. F. duPont" or "regular" account. The brokers were then to transfer the 62,500 shares from this long account to his "H. F. duPont Short No. 2" account, to be applied against the sale in that account on April 21, 1932, of 62,500 shares of common stock of the duPont Company. These instructions were executed by the brokers on the same day and the sale of 62,500 shares of common stock of the duPont Company in the "H. F. duPont Short No. 2" account was closed by such transaction. (R. 218.)

A dividend at the rate of 75 cents a share was declared on the duPont Company common stock, payable June 15, 1932, to stockholders of record of May 25, 1932. On June 15, 1932, Laird, Bissell & Meeds charged the "H. F. duPont Short No. 2" account \$46,875, representing the dividend paid on 62,500 shares. On the same day Laird, Bissell & Meeds credited the "H. F. duPont Special" account with a corresponding amount. (R. 218-219.)

For the purpose of computing the margin for carrying the accounts of the taxpayer during the year 1932, Laird, Bissell & Meeds considered his five accounts as one consolidated account (R. 219).

During all of the year 1932 Laird, Bissell & Meeds maintained daily records showing the long and short positions of its customers. These records consisted of large sheets of paper, one side of which was designated with the name of the stock involved and the word "long" and the other side was captioned with the name of the stock and the word "short." The names of the customers were listed alphabetically on each side of these sheets with the number of shares long or short at the close of the business day covered by each sheet. The sale of the 62,500 shares of common stock of the duPont Company, shown in the "H. F. duPont Short No. 2" account, was listed on the position record of Laird Bissell & Meeds as a short sale; the entry bore the penciled word "offset," which was intended to show that the taxpayer had long positions equal to

or in excess of his short positions on the days in question. The sale of the 62,500 shares of common stock of the duPont Company was not reported by Laird, Bissell & Meeds to the New York Stock Exchange in its reports of overnight short positions required under the rule of the committee on business conduct promulgated April 8, 1932. (R. 220-221.)

The Board of Tax Appeals held that there was a valid short sale under the circumstances of this case, but three members of the Board dissented on the ground that the taxpayer intended and contracted to sell specific shares of stock to the Christiana Company. The Circuit Court of Appeals affirmed the decision of the Board of Tax Appeals.

ARGUMENT

The transaction which the taxpayer might have accomplished was simple: the sale of 62,500 shares of the pledged duPont stock to the Christiana Company for \$2,000,000 and a corresponding reduction of his indebtedness to the Bankers Trust Company. Instead, through his agent, he chose a considerably more intricate series of transactions: (1) he obtained a loan of \$2,000,000 from his brokers; (2) this was paid to the Bankers Trust Company in reduction of his indebtedness; (3) the brokers received 62,500 shares of duPont common from Bankers Trust, to be held as collateral for this loan; (4) the taxpayer's long account was credited with 62,500 shares; (5) the brokers obtained new certifi-

ates in their own name; (6) the taxpayer sold 62,500 shares short; (7) the brokers on behalf of the taxpayer sold 62,500 shares to the agent of the Christiana Company, delivering in part the certificates obtained from the transfer agent on surrender of those received from Bankers Trust Company and in part other certificates; and (8) the agent of the Christiana Company paid the brokers \$2,000,000 with which they discharged the debt of the taxpayer. At the close of April 21, 1932, the taxpayer thus had obtained the release of 62,500 shares from the Bankers Trust Company, which had been credited by his brokers to his long account; his brokers had delivered 62,500 shares to the Christiana Company and he had sold 62,500 shares from his short account.

The court below (R. 263-264) advanced the probable explanation of this devious substitute for a simple transaction. The taxpayer hoped that he could cover the short account by delivery from the long account, from other duPont stock held by the taxpayer, or by stock purchased on the open market, as later price movements would indicate the possibility of tax savings.¹ Whether or not this

¹ One supposes that the taxpayer would then have argued that gain or loss from the short sale was to be based upon the cost of the certificates actually delivered, and that the transactions by which Bankers Trust Company surrendered 62,500 shares and Christiana Company purchased 62,500 shares were those of his brokers, and not a sale of stock by him.

scheme would have worked, the taxpayer's agent was careful to specify that none of the certificates obtained from Bankers Trust Company should be delivered to Christiana Company. The plan had more of subtlety than foresight, for Section 23 (s) was added by the Revenue Act of 1932, enacted about six weeks after these transactions were executed,² with the result that the taxpayer's profit, realized through a short sale, must be taxed as ordinary income rather than as a capital gain.

The taxpayer concedes that his agent intended to make a short sale and that the bookkeeping entries of his broker recorded a short sale (Pet. 6-7), but contends that the brokers' records are false and that there was not in fact a short sale. The Board of Tax Appeals and the court below correctly determined that Ellis made a valid short sale of 62,500 shares of duPont common stock for the taxpayer. The taxpayer treated it as a short sale and covered the sale with long stock in August 1932. Moreover, the short sale of 62,500 shares of duPont common on April 21, charged to the "Short No. 2" account, was carefully kept a wholly separate and distinct transaction from the transfer of 62,500 shares from the Bankers Trust Company to his long account.

It may be pointed out also that the taxpayer did not buy 62,500 shares of duPont common stock on

² The provision appeared as Section 23 (u) of the bill as introduced in the House on March 7, 1932.

April 21, 1932. He merely arranged with Bankers Trust Company to release that amount of duPont stock as collateral for his loan and instructed his broker to deposit that amount of stock in one of his long brokerage accounts. It was not a purchase; it was merely a transfer. He reduced his loan with the Bankers Trust Company by \$2,000,000 and obtained 62,500 shares of duPont common stock which was immediately deposited with his broker as collateral for a loan in the same amount. When the taxpayer deposited the stock in his margin account, it was immediately turned over to a transfer agent who issued new certificates in the name of his broker and from that time the taxpayer had merely a claim upon unidentifiable certificates.

The fact that 405 certificates delivered by the taxpayer's brokers to Christiana's agent represented 40,500 shares which were issued by the transfer agent of the duPont Company in exchange for the certificates that Laird, Bissell & Meeds obtained from the Bankers Trust Company has no material significance. The certificates delivered to Christiana's agent were not the same certificates which Laird, Bissell & Meeds received from the Bankers Trust Company, but were in the name of Laird, Bissell & Meeds or in street names, while the certificates surrendered by the Bankers Trust Company were in the taxpayer's name.

There is no conflict with *Davidson v. Commissioner*, 305 U. S. 44, or with *Doyle v. Mitchell*

Brothers Co., 247 U. S. 179, and there has been no departure from the principle that conclusive effect should not be given to the intention of the parties or to bookkeeping entries. The certificates acquired from the Bankers Trust Company were not delivered to the Christiana Company, but instead certificates in the name of Laird, Bissel & Meeds, or in street names, were delivered. The taxpayer intended to, and did make a short sale, which was covered by the transfer of shares credited to his long account. The facts coincide precisely with both the intention of the parties and the bookkeeping entries.

Ruml v. Commissioner, 83 F. (2d) 257 (C. C. A. 2d), *Huntington Nat. Bank v. Commissioner*, 90 F. (2d) 876 (C. C. A. 6th), and *Commissioner v. Dashiell*, 100 F. (2d) 625 (C. C. A. 7th), merely hold that the taxpayer's intention to make a long sale must control even though his broker delivered before receiving the actual certificates. Here there was no such intention.

This Court has already denied certiorari in a case which is similar on its facts, and in which the question was whether selling "against the box" constitutes a short sale. *DuPont v. Commissioner*, 98 F. (2d) 459 (C. C. A. 3d), certiorari denied, 305 U. S. 631.

CONCLUSION

The decision of the court below is correct. There is no conflict of decisions. The petition should be denied.

Respectfully submitted.

FRANCIS BIDDLE,
Solicitor General.

SAMUEL O. CLARK, Jr.,
Assistant Attorney General.

SEWALL KEY,
J. LOUIS MONARCH,
MORTON K. ROTHSCHILD,
WARNER W. GARDNER,
Special Assistants to the Attorney General.

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